



State of New Jersey
DEPARTMENT OF THE TREASURY
DIVISION OF THE RATEPAYER ADVOCATE
31 CLINTON STREET, 11TH FLOOR
P.O. Box 46005
NEWARK NJ 07101

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CHRISTINE TODD WHITMAN
Governor

May 3, 1996

BRIAN W. CLYMER
State Treasurer
BLOSSOM A. PERETZ
Director

VIA FEDERAL EXPRESS

Office of the Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

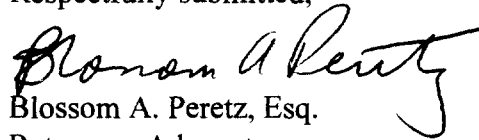
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Re: In the Matter of Implementation of Sections of the Cable
Television Consumer Protection and Competition Act of 1992 Rate
Regulation:
MM Docket No. 93-215
and
Adoption of a Uniform Accounting System for Provision of
Regulated Cable Service
CS Docket No. 94-28

TO THE HONORABLE COMMISSION:

Enclosed please find an original and nine copies of Comments to be filed with the Commission in the above-referenced matter. An additional copy is also enclosed which we respectfully request that the FCC time/date stamp and return it to our office in the return envelope. In addition, two additional copies are marked as "Extra Public Copy" pursuant to FCC's Public Notice of March 22, 1996.

Respectfully submitted,


Blossom A. Peretz, Esq.
Ratepayer Advocate

BAP/dp
Encl.

Office of the Secretary

May 3, 1996 —

Page 2

c: International Transcription Services, Inc.
2100 M St., N.W., Suite 140
Washington, D.C. 20037

President Herbert H. Tate, Board of Public Utilities
Commissioner Carmen J. Armenti, Board of Public Utilities
Commissioner Edward H. Salmon, Board of Public Utilities
James A. Nappi, Secretary, Board of Public Utilities
Celeste Fasone, Director, Off. Cable, Board of Public Utilities
Michael Ambrosio, Exec. Director, Board of Public Utilities
James Eric Andrews, DAG, Division of Law



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Before the
 FEDERAL COMMUNICATIONS COMMISSION
 Washington, D.C. 20554

In the Matter of)	
Implementation of Sections of the)	MM Docket No. 93-215
Cable Television Consumer Protection)	
and Competition Act of 1992)	
Rate Regulation:)	
)	
and)	
)	
Adoption of a Uniform Accounting)	CS Docket No. 94-28
System for Provision)	
of Regulated Cable Service)	

I. Introduction

On January 26, 1996, The Federal Communications Commission released its Second Report and Order, First Order On Reconsideration, and Further Notice of Proposed Rulemaking in the above referenced dockets. In its Further Notice of Proposed Rulemaking (FNPR), the Commission seeks comments regarding the use of the Capital Asset Pricing Model (CAPM) to determine an industry cost of equity and the use of a market valuation of equity to establish the proportion of equity in an operator's capital structure. The Commission also seeks comments on a proposal to use a cable operator's actual debt cost and capital structure to determine the operator's cost of capital in evaluating rates under a cost of service approach. The State of New Jersey, Department of the

Treasury, Division of the Ratepayer Advocate ("Ratepayer Advocate") respectively submits these comments in response to the Commission's FNPR.

The Ratepayer Advocate was established in 1994 by Governor Christine Todd Witman's Government Reorganization Plan. See 26 N.J.R. 2171 (June 6, 1995). It seeks to represent and protect the interests of all utility consumers--residential, small business, commercial and industrial, to ensure that they receive safe, adequate and proper utility service at affordable rates that are just, reasonable and nondiscriminatory. The Ratepayer Advocate is a statutory intervenor in cases where cable operators seeks to alter their rates or services through filings made at the New Jersey Board of Public Utilities (the "BPU").

II. The Current Methodology Is Reasonable And Should Be Retained

The Commission currently utilizes a presumptive unitary rate of return for cost of service filings by cable operators, and recognizes that the use of a unitary return simplifies the administrative burdens of regulatory review. In paragraph 194 of the FNPR, the Commission states that "if we adopt a more tailored rate of return methodology, we will nevertheless retain the current presumptive rate, and its concomitant procedures for overcoming that presumption, as an alternative to any new methodology." (emphasis added). The Ratepayer Advocate agrees that the current presumptive methodology should be retained. Furthermore, we recognize that cable operators have the opportunity to overcome this presumption if an operator believes that the presumptive unitary rate does not accurately reflect its capital costs. The Ratepayer Advocate believes that this current procedure obviates the need for yet another presumptive methodology as is being considered by the Commission.

The Ratepayer Advocate supports the availability of an option whereby any cable operator can justify a different rate of return than the presumptive rate. However, few, if any, cable operators within New Jersey have proposed an alternative rate. The number of cable operators making cost of service filings within the state is very small, as the overwhelming majority of operators have utilized a benchmark approach. The Ratepayer Advocate believes that the use of the benchmark approach by the vast majority of cable operators is further indication that the cable operators perceive no need to justify different rates under a cost of service approach using any rate of return methodology, and certainly there has been no showing that cable operators are inclined to attempt to overcome the presumptive unitary rate. Accordingly, the Ratepayer Advocate believes that the current methodologies are working well, and should be retained.

III. New Entrants Will Not Require A Change in Methodology

One of the Commission's concerns as addressed in paragraph 196 of the FNPR involves the entrance of new entities into the cable television marketplace, and the degree to which the presumptive unitary rate of return would fail to adequately reflect rates of return for these new entrants. However, the Commission's specific proposals address standards that are based only on existing cable operators. For example, in paragraph 200 the Commission states that the Capital Asset Pricing Model would "more accurately reflect the investor orientation that drives individuals and institutions to purchase the stocks of cable companies." (emphasis added). However, an investor in a new entrant that is not a traditional cable operator is purchasing the stock of an entire company, not only of that firm's cable operations. Therefore, the entrance of new players into the market should not necessarily dictate a change in the rate of return methodology used by the

Commission. Furthermore, the Commission goes on to suggest in paragraph 208 that it proposes to rely on data from the cable industry itself to determine an appropriate equity cost for cable operations. Such reliance would again call into the question the degree to which new entrants into the market should influence the selection of a new presumptive methodology.

IV. Only One Presumptive Methodology Should Be Adopted

If the Commission finds that the current unitary rate of return, which is based on the Discounted Cash Flow (DCF) approach, is no longer indicative of required returns on equity within the cable industry, then it should adopt a new unitary methodology. The Ratepayer Advocate believes that for administrative ease, only one presumptive methodology should be utilized. If a new presumptive methodology is selected, the Ratepayer Advocate would not be opposed to an approach that utilized the CAPM, rather than the DCF model for purposes of determining cost of equity.

With regard to the specific components of the CAPM proposed by the Commission, the Ratepayer Advocate is not opposed to the Commission's use of a beta of 1.42. The Ratepayer Advocate does, however, disagree with the Commission's proposal to utilize a risk-free rate and a risk premium based on average data from 1987 through the third quarter of 1995. The Advocate believes that use of data which is nine years old is too stale to provide an appropriate indicator of current risk premiums. Accordingly, the Advocate recommends that the risk-free rate and risk premiums be based upon an average of the last three years of data, and that this data be updated annually.

V. Average Equity Cost Rates Should Be Adopted

In paragraph 215 of the FNPR, the Commission seeks comments on a mechanism to establish average equity cost rates for cable operators with debt burdens significantly above or below the average leverage ratios used in its sample. If the CAPM is adopted for use in determining a presumptive rate, the Ratepayer Advocate does not believe that an alternative approach is either necessary or desirable. The benefit of a presumptive rate is that it eases the administrative burdens of both cable operators and regulatory agencies. While cable operators should have the option of justifying a different return if they believe that particular circumstances unique to their company warrant such an exercise, the Commission's proposal would provide a menu of presumptive rates upon which cable operators could pick and choose. Obviously, those presumptive rates resulting in the most advantageous returns would be selected, leaving the burden of overcoming this presumption to the Commission or state and local regulators. Rather than simplifying the process, the Ratepayer Advocate believes that the Commission's proposal to provide a myriad of alternatives to cable operators increases administrative burdens and provides no assurance that the process of regulation will result in rates of return that more accurately reflect each operator's cost of capital.

VI. Cable Operators Should Fully Justify All Financing From Affiliates

The Commission also invites comment on its proposal to utilize actual debt costs in the determination of its alternative rate of return methodology. While the Ratepayer Advocate is not generally opposed to the use of actual debt costs, we share the Commission's concern that financing by affiliated entities could inappropriately influence the cable operator's reported debt costs. The Commission proposes that any affiliated borrowings be separately identified. In addition, it states

that adjustments would be made "[t]o the extent that this debt cost exceeds debt cost that would have been incurred in the open market." See paragraph 220 of the FNPR. The Ratepayer Advocate believes, however, that the Commission's proposal places an undue burden on regulatory agencies for assessment of the appropriate debt costs. Accordingly, if the cable operator obtains debt financing from an affiliate, the cable operator should not only separately identify this financing, but it should be required to support the related cost as reasonable. While there is generally a presumption that actual debt costs are reasonable and prudent, this presumption should not apply to debt financing obtained from affiliates. Therefore, cable operators should demonstrate with their filings that the affiliated debt costs are at or below rates which could have been obtained in the open market.

VII. If An Actual Capital Structure Is Utilized, Then Actual Equity Ratios Should Be Employed

The Commission also recommends that a cable operator's actual capital structure be utilized to determine the company's overall rate of return. The Ratepayer Advocate is not opposed to the use of an actual capital structure. However, the Ratepayer Advocate disagrees with the Commission's proposal to adjust equity ratios to reflect market capitalization. As recognized by the FCC, there are many factors that influence market value. Furthermore, market prices exceeding book value imply that investors expect returns which exceed their cost of capital. Therefore, the use of market capitalization as a proxy for equity severs the relationship between traditional regulation and the provision of the opportunity for cable operators to earn a fair and reasonable rate of return. Accordingly, if the use of an actual capital structure is adopted, then the book debt and equity ratios applicable to each cable operator should be employed.

VIII. Summary

The Ratepayer Advocate believes that the Commission's current unitary presumptive return obviates the need for yet another presumptive methodology. While the Ratepayer Advocate supports the ability of a cable operator to justify an alternative return if conditions warrant, the use of the current unitary presumptive return provides administrative ease.

If the Commission finds that the current unitary rate of return should be revised, the Ratepayer Advocate would not object to the replacement of the current methodology with the CAPM approach. The Ratepayer Advocate recommends that if a CAPM approach is adopted, then the risk-free rate and risk premiums reflected in the CAPM should be based upon an average of the last three years of data, and that this data should be updated annually. Furthermore, if the CAPM is adopted for use in determining a presumptive rate, the Ratepayer Advocate does not believe that an alternative approach to modify the result for either highly leveraged or lightly leveraged companies is necessary.

With regard to debt costs, the Ratepayer Advocate is not opposed to the use of actual debt costs, but the Ratepayer Advocate recommends that cable operators should be required to demonstrate that any affiliated debt costs are at or below rates which could have been obtained in the open market. Furthermore, if an actual capital structure is adopted, the Ratepayer Advocate is opposed to modifying the equity ratio to reflect market capitalization.

The Ratepayer Advocate also respectfully requests that the Commission consider the minimal number of cost of service filings made within the State of New Jersey as further support for its position that there is no need for the Commission to revise its presumptive methodology at this time.

Respectfully submitted,

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Blossom A. Peretz, Director

Dated: May 3, 1996